31 March 2020

Global Tax Alert

US CARES Act has international tax implications

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

On 27 March 2020, United States (US) President Trump signed into law the roughly US$2 trillion bipartisan *Coronavirus Aid, Relief, and Economic Security Act*, H.R. 748 (CARES Act), which includes modifications to the Internal Revenue Code (IRC)[1] intended to provide economic relief to those impacted by the COVID-19 pandemic.

For multinational corporations, some of the more significant tax changes under the CARES Act consist of the following:

Changes to NOL rules under Section 172(a)

The CARES Act temporarily suspends the 80% taxable income limitation on the use of a net operating loss (NOL) to offset taxable income for tax years beginning after 31 December 2017 and before 1 January 2021. Taxpayers may elect to:

- Carry NOLs arising in any tax year beginning after 31 December 2017, and before 1 January 2021, back five years
- Exclude a Section 965 transition tax year from the five-year NOL carryback period

Taxpayers may not use the NOL carryback to directly reduce the amount of Section 965 transition tax incurred in a transition year. Taxpayers may still carry NOLs forward if they decide against carrying them back.

Building a better working world

The carryback or carryforward of an NOL may affect a taxpayer's: (1) allowable Section 250 deduction (both against foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI); (2) allowable foreign tax credits (FTCs); (3) base erosion anti-abuse tax (BEAT) liability; and (4) in some cases, the taxpayer's Section 965 transition tax liability.

Temporary changes to Section 163(j) limitation

The CARES Act generally allows taxpayers to increase the 30% of adjusted taxable income (ATI) limitation on business interest expense to 50% of ATI for any tax year beginning in 2019 or 2020. Taxpayers may elect not to apply the higher 50% limitation. Taxpayers may also elect to use their 2019 ATI (in lieu of 2020 ATI) in their 2020 tax year to calculate their 2020 Section 163(j) limitation. If the additional deduction yields negative tax consequences for another tax provision, such as Section 59A (BEAT), taxpayers may decide not to elect to apply the increased Section 163(j) limitation.

For tax year 2019, partnerships must use the 30% of ATI limitation. The ATI limitation increases to 50% of ATI for partnerships in their 2020 tax years, unless the partnership elects not to apply the higher limitation. The partnership may elect to substitute tax year 2019 ATI for tax year 2020 ATI.

Partners may treat 50% of any excess business interest expense (EBIE) allocated to them from a partnership in tax year 2019 as automatically paid or accrued to them in the partner's 2020 tax year, without further Section 163(j) limitations at the partner level (i.e., the partner can deduct that 50% portion regardless of the partner's ATI). The remaining 50% of 2019 EBIE is subject to the "normal" testing rules for EBIE at the partner level (i.e., the partner needs to receive an allocation of excess taxable income (ETI) from that same partnership in future tax years to potentially free up those amounts). The partner may elect not to apply this special rule.

Implications

The modification to the NOL carryback rules may yield a cash benefit to taxpayers that can use their NOLs. There may, however, be some unanticipated international tax consequences arising from the interaction of modified Section 172(a) with other IRC provisions.

Section 965 transition tax: Carrying an NOL to a pre-transition tax year does not directly impact the amount of a taxpayer's transition tax inclusion. However, the NOL deduction claimed in that carryback year could increase the taxpayer's FTC carryover from that year. The FTC carryover would need to be taken into account in each succeeding tax year under Section 904(c), and a greater FTC carryover could be available in the Section 965 transition tax year (whether 2017 or 2018), thus reducing the taxpayer's transition tax liability.

Section 250 deduction: The CARES Act does not amend the taxable income limitation in Section 250(a)(2), which otherwise reduces the allowable Section 250(a)(1) deduction when the sum of a taxpayer's FDII and GILTI exceeds its taxable income for the year (without regard to Section 250). Effectively, the Section 250(a)(2) limitation may result in taxpayers utilizing a 21% tax attribute (an NOL deduction) against items of income (FDII and GILTI), subject to a lower rate of tax because of the Section 250 deduction.

FTC limitation: A greater NOL deduction will reduce a taxpayer's FTC limitation under Section 904, whether the NOL source is foreign or domestic. As previously noted, a taxpayer will generally have a greater FTC carryforward coming out of the NOL carryback year. A domestic-source NOL may create, or increase, an overall domestic loss (ODL) account, which may be beneficial in a subsequent tax year. An ODL account from a pre-*Tax Cuts and Jobs Act* (TCJA) tax year would be subject to the transition rules included in the final FTC regulations (TD 9882). A foreign-source NOL may create, or increase, a separate limitation loss or an overall foreign loss account, which could be detrimental in a subsequent tax year, including in the Section 965 transition tax year. The transition rules in TD 9882 would apply to this account when transitioning from a pre-TCJA tax year to a post-TCJA tax year.

Taxpayers should also consider the tax rate differential between pre-TCJA and post-TCJA tax years. Generally, FTCs carried to pre-TCJA years offset income taxed at 35%, while FTCs utilized in a post-TCJA year will offset income taxed at a maximum 21% rate.

BEAT liability: An NOL carryback to a tax year for which Section 59A is effective could create or increase a taxpayer's BEAT liability. Simply stated, an NOL deduction reduces a taxpayer's regular tax liability, which can create or increase the taxpayer's base erosion minimum tax amount. As a result, a taxpayer that is an applicable taxpayer, as defined for BEAT purposes, and that elects to carry back an NOL may be subject to a BEAT liability depending on its adjusted regular tax liability in the carryback year. This will likely come as a surprise to many taxpayers.

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United States), International Transaction Tax Services

- Craig Hillier craig.hillier@ey.com
- Jose Murillo jose.murillo@ey.com
- Arlene Fitzpatrick arlene.fitzpatrick@ey.com
- Martin Milner martin.milner@ey.com
- Ben Orenstein benjamin.orenstein@ey.com
- Deborah Tarwasokono deborah.tarwasokono@ey.com

Ernst & Young LLP (United States), Partnerships and Joint Ventures Group

- Mark Opper mark.opper@ey.com
- Jeff Erickson jeff.erickson@ey.com
- Morgan Anderson morgan.anderson@ey.com

International Tax and Transaction Services

Global ITTS Leader, **Jeffrey Michalak,** *Detroit*

ITTS Director, Americas, **Craig Hillier,** *Boston*

ITTS Markets Leader, Americas, **Laynie Pavio,** *San Jose, CA*

ITTS NTD Leader, **Jose Murillo,** *Washington, DC*

ITTS Regional Contacts, Ernst & Young LLP (US)

West
Sadler Nelson, *San Jose*

East
Colleen O'Neill, *New York*

Central
Aaron Topol, *Atlanta*

Financial Services
Chris J Housman, *New York*

Canada - Ernst & Young LLP (Canada)
Warren Pashkowich, *Calgary*

EY | Assurance | Tax | Transactions | Advisory

EYG no. 001660-20Gbl

1508-1600216 NY
ED None

ey.com